UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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| IN RE WORLDCOM, INC. SECURITIES LITIGATION<br><br>This Document Relates to: | MASTER FILE<br>02 Civ. 3288 (DLC) |
| PUBLIC EMPLOYEES RETIREMENT SYSTEM OF OHIO, et al.,<br><br>Plaintiffs,<br>-v-<br><br>BERNARD J. EBBERS, et al.,<br><br>Defendants. | No. 03 Civ. 338<br><br>OPINION & ORDER |

Appearances:

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DENISE COTE, District Judge:

On June 25, 2002, WorldCom, Inc. ("WorldCom") made the first of several announcements that it would restate publicly filed financial reports. Since then, WorldCom has admitted that its financial reports filed with the SEC from 1999 through the first quarter of 2002 were overstated by approximately $9 billion.

Many lawsuits have been filed alleging claims in connection with WorldCom's collapse, and assigned to this Court by the Judicial Panel on Multi-District Litigation ("MDL Panel"). The actions transferred to this Court include actions alleging individual ("Individual Actions") as well as class claims.[1] This

[1] By Opinion and Order dated May 28, 2003, the Individual Actions were consolidated with the Consolidated Class Action for pre-trial purposes. Numerous Opinions and Orders have been issued in the consolidated WorldCom Securities Litigation. Of particular import to this Opinion are the Opinion and Order denying, with one limited exception, defendants' motions to dismiss the Class Action Complaint, In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 21219049 (S.D.N.Y. May 19, 2003), and the Opinion and Order granting the lead plaintiffs' motion to certify a class, In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 22420467 (S.D.N.Y. Oct. 24, 2003).

Opinion addresses a motion to dismiss claims brought in one of the Individual Actions.[2]

Citigroup, Inc., Salomon Smith Barney, Inc. n/k/a Citigroup Global Markets, Inc. ("SSB"), and Jack Grubman ("Grubman")(together, "SSB Defendants") move to dismiss ten of the causes of action in the complaint filed in the above-captioned action by Ohio pension fund plaintiffs ("Ohio Plaintiffs," "Ohio Action" and "Ohio Complaint"),[3] on the ground that the Ohio Plaintiffs were on notice of claims relating to the SSB Defendants' analyst reports as of September 2000 and that their claims, originally filed two years later, on September 24, 2002, are time-barred. For the reasons set forth below, the motion is denied.

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[2] A September 22, 2003 Order set a briefing schedule for two initial phases of motions to dismiss claims in the Individual Actions. The first tranche of the motions to dismiss claims common to many Individual Actions was addressed to statute of limitations issues and a claim brought in connection with a December 2000 private placement of WorldCom bonds. An Opinion of November 21, 2003, addressed those issues in connection with another of the Individual Actions. See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 22738546 (S.D.N.Y. Nov. 21, 2003). The second tranche of the motions will address preemption issues under the Securities Litigation Uniform Standards Act of 1998 and issues specific to holding companies. The second tranche of motions will be fully submitted on December 5, 2003.

[3] The Ohio Plaintiffs consist of the Public Employees Retirement System of Ohio, State Teachers Retirement System of Ohio, School Employees Retirement System of Ohio, Ohio Police and Fire Pension Fund, Ohio State Highway Patrol Retirement System, Ohio Bureau of Workers' Compensation, and Cincinnati Retirement System.

This motion is the latest iteration of the unrelenting effort by the SSB Defendants to carve out of the pleadings those accusations that they had an illicit quid pro quo relationship with WorldCom, and a duty to disclose that relationship. See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 22533398 (S.D.N.Y. Nov. 6, 2003) (motion for certification of an interlocutory appeal); In re WorldCom, Inc. Sec. Litig., 2003 WL 22420467 (class certification); In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049 (motion to dismiss); In re WorldCom, Inc. Sec. Litig., 2003 WL 1563412 (S.D.N.Y. Mar. 25, 2003) (motion to sever). The allegations about the improper relationship, however, do not stand alone in any of the claims. They are intertwined with allegations that the SSB Defendants misrepresented WorldCom's financial condition. The allegations about the relationship between WorldCom and its chief investment banker, SSB, are used, for example, to explain why the SSB Defendants made misrepresentations about WorldCom's financial condition both in registration statements filed in connection with WorldCom bond offerings underwritten by SSB and in Grubman's analyst reports.

In any event, the press reports to which the SSB Defendants point in this motion were insufficient to put WorldCom investors on inquiry notice of the fraud and misconduct by the SSB Defendants alleged in the Ohio complaint. The following description summarizes the allegations in the Ohio Complaint relevant to this Opinion.

The Ohio Complaint

The initial complaint in the Ohio action was filed in the Court of Common Pleas of Franklin County, Ohio, on September 4, 2002. It was removed by the defendants to federal court and transferred to this Court by the MDL Panel in January 2003. Pursuant to the May 28 Consolidation Order,[4] the Ohio Plaintiffs filed an amended complaint on July 11, 2003. The parties and the Court have relied upon the July 11, 2003 pleading in describing the allegations made by the Ohio Plaintiffs. The timeliness of the action, however, is measured from September 4, 2002, the date the initial complaint was filed.

The Ohio Plaintiffs allege that WorldCom used fraudulent accounting practices to inflate its revenues and earnings artificially from August 1998 through April 2002. Among the fraudulent accounting practices, Ohio Plaintiffs identify in particular WorldCom's accounting for acquisitions, merger reserves, "line costs,"[5] capital expenditures, ordinary operating expenses, impaired assets, customer refunds, and booking of fictitious revenue. By November 2002, WorldCom had admitted that

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[4] The May 28 Consolidation Order provided that Individual Actions transferred to this Court by the MDL Panel have the later of July 11, 2003 or twenty-one days following arrival on this Court's docket to file an amended pleading.

[5] Line costs are the costs incurred by WorldCom's long-term lease agreements with various telecommunications carriers to allow WorldCom to use the carriers' networks to carry the calls of WorldCom's customers.

it had overstated its pretax income for 1999 through the first quarter of 2002 by approximately $9 billion.

Citigroup is an international financial services institution that, through its subsidiaries like SSB, provides commercial and investment banking services, commercial loans, and acts as an underwriter in the sale of corporate securities. In September 1999, Citigroup arranged an undisclosed $499 million loan from its subsidiary, The Travelers Company, to an entity controlled by WorldCom's Chief Executive Officer, Bernard J. Ebbers.

SSB, the investment banking and brokerage subsidiary of Citigroup, employed Jack Grubman as its telecommunications analyst. Grubman enjoyed a reputation as the preeminent analyst in the telecommunications sector, and could purportedly "make or break" a stock with his research reports. Grubman helped SSB garner lucrative investment banking business from the telecommunications companies he covered and, as a result, was one of the highest paid analysts in the securities industry. Grubman had close and undisclosed ties to WorldCom and Ebbers. Because of his insider access, Grubman knew that WorldCom was concealing adverse facts. He attended meetings of WorldCom's board of directors and advised the board on planned transactions. He failed to disclose in his analyst reports that he lacked any reasonable factual basis for his recommendations, and failed to disclose his and SSB's significant material conflicts of interest. On December 20, 2002, Grubman agreed to pay a fine of

$15 million for issuing false and misleading analyst reports and was banned from the securities industry for life.

SSB was the book running manager and co-lead underwriter for WorldCom's May 2000 bond offering and was the joint book-runner and co-lead underwriter for WorldCom's May 2001 bond offering. SSB published frequent research reports regarding WorldCom, at the same time it managed WorldCom's stock option plans and advised the company on numerous investment banking transactions. Between October 1997 and February 2002, SSB received a net of $107 million in fees for its investment banking business with WorldCom. SSB provided significant amounts of IPO shares to WorldCom executives.

The analyst reports issued by SSB and Grubman contained materially false and misleading statements and omitted material information. In particular, SSB and Grubman knew or recklessly disregarded that WorldCom was falsely reporting its financial condition and the status of its business operations. SSB and Grubman deliberately excluded that information from their research reports and instead issued materially misleading positive appraisals of WorldCom's value. Grubman disguised WorldCom's true financial condition by manipulating the analytical model that he used to evaluate the company. Not only did Grubman author his own materially misleading statements, but he also scripted analyst conference calls for Ebbers, in which Ebbers reassured investors as to WorldCom's financial well-being. After the conference calls, Grubman would issue analyst reports reinforcing Ebbers's reassurances about WorldCom. In exchange for allocating valuable IPO shares to WorldCom executives and issuing materially misleading analyst reports that inflated the value of WorldCom's securities, Grubman and SSB received WorldCom's lucrative investment banking business and the substantial fees it generated. SSB earned approximately $107 million in fees, which it in turn used to calculate Grubman's $20 million a year salary.

The lengthy and detailed allegations of the Ohio Complaint describe not only the allegedly illicit lucrative quid pro quo relationship between Ebbers and WorldCom on the one hand and SSB and Grubman on the other, but also the extensive conflicts of interest between SSB's investment banking business and its research department more generally. The Ohio Plaintiffs allege that SSB in effect integrated its research and investment banking departments, and used its analyst reports and ratings to generate substantial lucrative underwriting and investment banking business. The Ohio Plaintiffs describe the extensive determinations made by the New York Attorney General as a result of his investigation into the Wall Street research analysts. Among other things, the Attorney General found that SSB and Grubman issued false a misleading research reports on certain telecommunications companies from 1999 through 2001 and that during that time SSB earned more than $790 million in investment banking revenues; SSB put pressure on research analysts to maintain coverage or favorable ratings for its investment banking clients; and SSB engaged in improper spinning and IPO distributions. On December 23, 2002, government regulators announced a global settlement of research report-related investigations. SSB agreed to pay $400 million in settlement, twice as much as any of the other investment banks involved.

The Complaint pleads fifteen causes of action, fourteen of which name at least one of the SSB Defendants. Claims one through four plead common law claims of fraud and deceit (I), conspiracy to commit fraud (II), negligent misrepresentation (III), and aiding and abetting fraud (IV). Claims five and six plead violation of the Mississippi Securities Act (V and VI). Claim seven alleges violations of common law, Mississippi statutory law, and the federal securities laws in connection with Citigroup's supervision of SSB and Grubman, and SSB's supervision of Grubman (VII). Claim eight alleges violations of law solely against WorldCom's outside auditor (VIII). The next four claims plead violations of Section 11 ("Section 11") of the Securities Act of 1933 ("Securities Act")(IX to XII). Claim thirteen alleges a violation of Section 15 of the Securities Act (XIII). The remaining two claims allege violations of the Securities Exchange Act of 1934 ("Exchange Act"), specifically of Section 10(b)(XIV) and Section 20(a)(XV).

Discussion

The SSB Defendants move to dismiss ten of the fifteen claims pleaded against them on the ground that the plaintiffs had ample notice of their potential claims based on Grubman's analyst reports as of September 2000, and yet failed to file their complaint until over two years later, on September 4, 2002.[6] The SSB Defendants rely on press reports before September 2000, which they contend gave the plaintiffs a duty to inquire into the conflicts of interest that are alleged to have undermined the reliability of the analyst reports. September 2000 is twenty-one months before WorldCom's June 2002 announcement that it would have to restate its financials.

With respect to the Exchange Act claims, the parties agree that a two year statute of limitations governs.[7] In July 2002, in response to the WorldCom disaster, Congress enacted the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). Section 804 of Sarbanes-Oxley lengthened the statute of limitations for private

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[6] The SSB Defendants do not move to dismiss claims I through IV and VIII. Moreover, their statute of limitations arguments are not directly addressed to the five Securities Act claims in claims IX through XIII. The Securities Act claims are not pleaded in fraud and are not governed by the two year inquiry notice period that applies to Exchange Act claims. See In re WorldCom, Inc. Sec. Litig., 2003 WL 22738546, at *5-9. This motion, therefore, in fact addresses at most five claims: the two claims brought under the Mississippi Securities Act (V and VI), the catch-all supervision claim (VII), and the two Exchange Act claims (XIV and XV). The SSB Defendants themselves only refer to three claims: the two Exchange Act claims (XIV and XV), and the catch-all supervision claim (VII).

[7] The parties assert that the statute of limitations for the state common law claims brought under Ohio and Mississippi law is four and three years, respectively, and under the Mississippi Securities Act is two years. The federal Securities Act claims are governed by Section 13 of the Securities Act, 15 U.S.C. § 77m, and must be commenced by the lesser of one year from discovery, or three years from the filing or issuance of the document underlying the claim. See In re WorldCom, Inc. Sec. Litig., 2003 WL 22738546, at *5-9.

causes of action alleging securities fraud to allow them to be filed within two years after discovery of the fraud. See 28 U.S.C. § 1658 ("Section 804"). Section 804 provides in pertinent part that

> a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the [Exchange Act] [15 U.S.C. § 78c(47)], may be brought not later than the earlier of --
> (1) 2 years after the discovery of the facts constituting the violation; or
> (2) 5 years after such violation.

28 U.S.C. § 1658 (emphasis supplied). The parties agree that plaintiffs thus had two years from the time they were on notice of their Exchange Act claims to bring suit.

When a plaintiff was on inquiry notice of claims arising from the collapse of WorldCom was recently addressed by this Court. See In re WorldCom, Inc. Sec. Litig., 2003 WL 22738546, at *9-12. Familiarity with that Opinion is assumed. To summarize, if an investor makes no inquiry, knowledge of the claim will be imputed as of the date the duty to inquire arose. See LC Capital Partners LP v. Frontier Ins. Group, Inc., 318 F.3d 148, 154 (2d Cir. 2003). The circumstances giving rise to the duty to inquire are known as "storm warnings," see Levitt v. Bear Stearns & Co., 340 F.3d 94, 101 (2d Cir. 2003), and must be triggered by information that "relates directly to the misrepresentations and omissions the Plaintiffs later allege in their action against the defendants." Newman v. Warnaco Group, Inc., 335 F.3d 187, 193 (2d Cir. 2003). An investor does not "have to have notice of the entire fraud being perpetrated to be on inquiry notice." Dodds v. Cigna Secs., Inc., 12 F.3d 346, 351-52 (2d Cir. 1993). The fraud indicated by the storm warnings, however, "must be probable, not merely possible." Newman, 335 F.3d at 193 (citation omitted).

In some cases, despite the presence of storm warnings, investors are not placed on inquiry notice "because the warning signs are accompanied by reliable words of comfort from management." LC Capital, 318 F.3d at 155. Such statements must be considered, but will not affect the duty to inquire unless "an investor of ordinary intelligence would reasonably rely on the statements to allay the investor's concern." Id. "Whether reassuring statements justify reasonable reliance that apparent storm warnings have dissipated will depend in large part on how significant the company's disclosed problems are, how likely they are of a recurring nature, and how substantial are the 'reassuring' steps announced to avoid their recurrence." Id. Whether a plaintiff was placed on inquiry notice "is often inappropriate for resolution on a motion to dismiss under Rule 12(b)(6)" but, if the facts needed to make the determination "can be gleaned from the complaint and papers integral to the complaint, resolution of the issue on a motion to dismiss is appropriate." Id. at 156 (citation omitted); see also Dodds, 12 F.3d at 352 n.3.[8]

[8] The plaintiffs who file Individual Actions cannot take advantage of the tolling doctrine known as American Pipe tolling.

One serious flaw in this motion should be noted at the outset. Although this motion is addressed only to the Grubman analyst reports, none of the claims addressed by this motion is based solely on those analyst reports. As WorldCom's lead investment banker for many of its public offerings, the SSB Defendants are also responsible for representations about WorldCom's financial condition in the registration statements for those public offerings. The Exchange Act claims and other claims at issue on this motion seek to hold the SSB Defendants liable not only for the analyst reports but also for the registration statements.

Addressing simply the analyst report issues encompassed by the motion, the SSB Defendants contend that press reports regarding conflicts between research and investment banking departments at large financial institutions constituted "storm warnings" that served to put the Ohio Plaintiffs on notice of their claims regarding the analyst reports by September 2000.[9]

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See American Pipe & Construc. Co. v. Utah, 414 U.S. 538, 554 (1974); see also In re WorldCom, Inc. Sec. Litig., 2003 WL 22738546, at *14-17 (discussing cases).

[9] The SSB Defendants also contend that the standard disclosures that were made in SSB analyst reports -- to the effect that within the past three years, SSB "may have" performed investment banking services for "any company mentioned in th[e] report," and if a particular transaction were discussed, that it had an investment banking involvement in the transaction -- were sufficient to place the plaintiffs on notice of the illicit relationship described in the Ohio Complaint. These disclosures were insufficient to provide notice that the integrity of the analyst reports had been undermined by the extensive and unusual exchanges of benefits alleged in the Ohio Complaint.

The SSB Defendants argue that the press reports reached a crescendo between 1998 and 2000, when they described the pervasive conflicts facing research analysts. The press reports they rely upon are found in newspapers and magazines large and small -- from the Wall Street Journal to Tulsa World. They describe not only conflicts of interest between research and investment banking, but also dubious spinning practices and improper allocations of IPO shares to investment banking clients.

Many of the articles to which the SSB Defendants point address the conflicts that existed on Wall Street generally, and do not discuss WorldCom and SSB in particular. With respect to Grubman himself, however, at least one report mentions Grubman's "friendship" with Ebbers, and another notes that Grubman attended meetings normally off-limits to analysts. Another report noted that Grubman's "dual role" as an analyst and deal broker was fraught with complications, was hard to police, and required reliance on his integrity. A July 2000 Washington Post article highlighted Grubman's role in touting a transaction and the investment banking fees earned on the transaction by SSB.

Of course, during this same time, the SSB Defendants were reassuring the public about the independence of their financial reporting and the reliability of their work. Grubman himself, and the chief of research at his firm, specifically denied that they labored under any conflict and asserted that the firm's work, and Grubman's analyst reports in particular, were the result of objective research.

The press reports in the years before September 2000 do not sufficiently reveal the alleged extensive and illicit quid pro quo relationship between SSB and Grubman on the one hand and WorldCom and Ebbers on the other that is the basis for the Ohio Plaintiffs' fraud claims. It should be noted that it was not until July 2002 that the IPO allocations at SSB became the focus of government investigations. None of the earlier press reports revealed that the SSB Defendants were allocating "hot IPOs" to Ebbers and other WorldCom executives. The hundreds of millions of dollars of loans by the SSB Defendants to Ebbers that were secured by WorldCom stock and that gave Citigroup an additional financial stake in WorldCom's stock price were not publicly disclosed until they were reported in the Amended Class Action Complaint in October 2002. In October 2002, Citigroup's CEO apologized for the first time for his company's business practices. In December 2002, Grubman agreed to pay a $15 million fine for issuing false and misleading analyst reports.

While press reports need not reveal the details of a fraud, they must be sufficiently revealing to make the existence of the fraud probable. See Newman, 335 F.3d at 194. The press reports on which the SSB Defendants rely are simply too vague to support a conclusion that, as a matter of law, plaintiffs were on notice as early as September 2000, of their potential claims that an illicit relationship between the SSB Defendants and WorldCom had tainted financial reporting about WorldCom in the analyst reports.

In this regard, it is worth restating that the Ohio Plaintiffs' claims, like the claims in the Consolidated Class Action, arise from the alleged manipulation of the financial statements of WorldCom, and the alleged false and misleading statements about WorldCom’s finances made to the public as a result of that manipulation. The claims against the SSB Defendants allege that SSB and Grubman knew or recklessly disregarded material non-public adverse information about WorldCom's financial position and the value of its securities and that they issued false and misleading analyst reports in exchange for lucrative investment banking business. The SSB Defendants do not dispute that the Ohio Plaintiffs were first put on notice of the accounting fraud on June 25, 2002, when WorldCom announced its restatement.

It is ironic that the SSB Defendants now contend that the conflicts of interest that they have so vigorously argued are insufficient to sustain fraud allegations were sufficiently reported in the business press to put plaintiffs on notice of their fraud claims as early as 2000. This motion by the SSB Defendants ultimately rests on one opinion issued by a distinguished and experienced colleague. The SSB Defendants rely on the opinion of the Honorable Milton Pollack in the Merrill Lynch research reports litigation. See In re Merrill Lynch & Co. Research Reports Sec. Litig., 273 F. Supp. 2d 351 (S.D.N.Y. 2003) (In re Merrill Lynch & Co. 24/7 Real Media, Inc. Research Reports Sec. Litig. & In re Merrill Lynch & Co. Interliant Inc. Research

Reports Sec. Litig.) ("Merrill Lynch III"). As Judge Pollack himself has noted, the allegations in the WorldCom Securities Litigation differ significantly from those in the Merrill Lynch cases. See id. at 364 n.25. The revelations in the press that were sufficient in Merrill Lynch to support dismissal of those claims for failure to plead loss causation are of no assistance to the SSB Defendants here. The Ohio Complaint rests on different allegations and raises different issues. See In re WorldCom, Inc. Sec. Litig., 2003 WL 22533398, at *11; In re WorldCom, Inc. Sec. Litig., 2003 WL 22420467, at *29 n.45.

## Conclusion

The motion by the SSB Defendants to dismiss certain claims in the Ohio Action as time-barred is denied.

SO ORDERED:

Dated: New York, New York
November 25, 2003

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DENISE COTE
United States District Judge